



*As reprinted from 10/24/2008*

## **Economy a factor as Arizona budget woes worsen**

PHOENIX - The Grand Canyon has a rival: the still-growing crater in Arizona's state budget.

The \$9.9 billion budget appears headed toward a \$1 billion-plus revenue shortfall. That's above and beyond the \$1.9 billion of red ink that lawmakers had to erase when they approved the budget last June.

Add it all up and the total projected shortfall represents about 30 percent of the entire budget, for one of the biggest state budget shortfalls nationwide by percentage.

And with no economic recovery in sight, the prognosis for Arizona's next budget also looks grim. Legislative budget analysts offer scenarios for revenue shortfalls ranging from \$1.1 billion to \$3 billion for the fiscal year that begins next July 1.

That has Democratic Gov. Janet Napolitano and both parties' legislative leaders planning to meet Nov. 6, right after the election, to discuss strategies for lawmakers to consider, possibly during a lame-duck legislative session.

Multiple factors combined to produce the state's fiscal troubles.

Most obviously, with the housing industry's collapse, auto sales down by nearly a third and sky-high rankings for job creation a thing of the past, tax collections have dropped well below already gloomy projections used in drafting the state budget.

But the state was already on precarious ground, with spending outpacing revenue and a budget bottom line that was skinned back by tax cuts but bolstered by borrowing and other tactics.

Looking ahead, lawmakers' hands are tied politically and legally.

Napolitano insists on protecting education and some social services from cuts. Meanwhile, a constitutional protection for voter-approved laws shields big chunks of spending for health care and education from potential budget cuts.

The state has already used most of its traditional budget-balancing maneuvers. Those include tapping the rainy day fund, delaying payments to school districts and raiding special-purpose accounts. And the state freed up cash by borrowing hundreds of millions of dollars to pay for building new K-12 schools.

"Basically the cushion is gone," said State Treasurer Dean Martin, a Republican former state senator who thinks the current budget's shortfall could reach \$1.5 billion. "I'm glad I'm not in the Legislature having to figure this one out."

After prodding from Republican lawmakers who pointed to hundreds of job openings listed on state web sites, Napolitano last spring implemented a partial hiring freeze that has produced more than 1,000 vacancies so far. More recently, she has ordered agencies to eliminate nonessential travel and work with her budget staff to produce budget-cutting options.

"We are cutting back significantly on the budget that has been appropriated," said Napolitano. However, "cutting expenditures is not going to do it. We don't have that kind of liberty in this budget."

But Napolitano has drawn the line on slashing some spending, saying she won't make shortsighted cuts that would hurt K-12 schools, higher education and programs protecting children and vulnerable adults.

"I'm talking about the need to really make smart budget decisions that don't cut off our long-term vision and our ability to rebound quickly," Napolitano said.

Bryon Schlomach, a Goldwater Institute researcher, said Napolitano is "continuing the party on the Titanic" if the state doesn't reduce spending in big-ticket programs like education and health care for the poor.

"The choice is not between cutting and spending. It is between cutting and putting the state in receivership," he said.

Former state President Ken Bennett, a Prescott Republican who negotiated several budgets with Napolitano while in the Legislature during her first term, said she insisted on including budget surpluses in the following years' revenue projections in order to accommodate spending that outpaced inflation and population growth.

"She wanted to count everything that we had left over from those good years," Bennett recalled. "I kept saying it'll be fine for one year. As it turned out it was OK for two years."

Along with draining what's left from the rainy day fund and squeezing state agency spending, Napolitano's preliminary budget-balancing plan includes exploring "budget management options." Those could include selling off a portion of the lottery and charging other states a new fee to send inmates to private prisons in Arizona.

Some advocacy groups are discussing the possibility of tax increases, but Napolitano says she isn't proposing any tax increase. However, she says the state can't afford to permanently repeal a property tax that was suspended in 2006 for three years starting in 2006 at a cost of over \$200 million annually.

Another tax cut approved in 2006 reduced the income tax by 10 percent, or \$334 million annually, over two years.

The 2006 tax reductions were championed by Republican lawmakers but Napolitano went along with them in budget compromises that included her spending priorities.

"At the time, based on the forecasts we were given, it looked like those income tax cuts would be affordable within the Arizona budget," Napolitano said.

"The plain fact of the matter is the national economy, from which Arizona is not immune, took a turn that really has become kind of a perfect storm of events and nobody really predicted that, so you deal with what you have."

By PAUL DAVENPORT 10.24.08, 1:13 PM ET